DEPARTMENT OF STATE REVENUE

04-20120472.LOF

Letter of Findings: 04-20120472
Sales and Use Tax
For Tax Years 2006 and 2007

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ISSUES

I. Sales and Use Tax – Exemptions.

Authority: IC § 6-2.5-1-2; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-4-1; IC § 6-2.5-5-3; IC § 6-2.5-5-5.1; IC § 6-8.1-5-1; 45 IAC 2.2-3-20; 45 IAC 2.2-3-21; 45 IAC 2.2-5-8; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Indiana Dep't of State Revenue v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974); Rhoade v. Indiana Dep't of State Revenue, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466 (Ind. Tax Ct. 1993); Indiana Dep't. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); Mumma Bros. Drilling Co. v. Indiana Dep't. of State Revenue, 411 N.E.2d 676 (Ind. Ct. App. 1980); Indiana Dep't. of Revenue v. Interstate Warehousing, Inc., 783 N.E.2d 248 (Ind. 2003); General Motors Corp. v. Indiana Dep't. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Hartranft v. Wiegmann, 121 U.S. 609 (1887); Anheuser-Busch Brewing Ass'n v. United States, 207 U.S. 556 (1908); Indiana Creosoting Co. v. McNutt, 5 N.E.2d 310 (Ind. 1936); Mechanics Laundry & Supply, Inc. v. Indiana Dep't of State Revenue, 650 N.E.2d 1223 (Ind. Tax Ct. 1995); White River Envtl. P'ship v. Indiana Dep't of State Revenue, 694 N.E.2d 1248 (Ind. Tax Ct. 1998); Indianapolis Fruit Co. v. Indiana Dep't of State Revenue, 691 N.E.2d 1379 (Ind. Tax Ct. 1998); Rotation Products Corp. v. Indiana Dep't of State Revenue, 690 N.E. 2d 795 (Ind. Tax Ct. 1998); Black's Law Dictionary (8th ed. 2004).

Taxpayer protests the Department's proposed assessments of sales/use tax.

II. Tax Administration – Interest.

Authority: IC § 6-8.1-10-1.

Taxpayer protests the imposition of statutory interest.

III. Tax Administration – Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an out-of-state Subchapter S Corporation. Taxpayer provides "asset retirement" services, including, but not limited to, "structural demolition," "selective demolition," "asbestos abatement," "foundation removal," "waste segregation/disposal," "salvage segregation/recycling," and "tank decommissioning," throughout the United States.

In December 2009, Taxpayer filed one claim for refund of sales/use tax ("Claim One," Claim Number 278628) that it paid during tax year 2006. In December 2010, Taxpayer filed another claim for refund of sales/use tax ("Claim Two," Claim Number 287434) that it paid during tax year 2007. The Indiana Department of Revenue ("Department") initially reviewed both claims and granted the refunds, but subsequently assessed Taxpayer when the refunds were found to have been erroneously granted.

Taxpayer timely protested the Department's proposed assessments. Taxpayer, however, requested that the Department make the determination without a hearing because the basis of its protest is identical as its previous protest (Docket Number 04-20110255R). As a result, this Letter of Findings is based on the information within Taxpayer's protest file. Further facts will be supplied as required.

I. Sales and Use Tax – Exemptions.

DISCUSSION

Taxpayer asserted that it was entitled to the refunds pursuant to statutory exemptions outlined in IC § 6-2.5-3-2(e) and IC § 6-2.5-5.

As a threshold issue, all tax assessments are prima facie evidence that the Department's assessment of tax is presumed correct. "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007); Indiana Dep't. of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired

in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). The use tax is functionally equivalent to the sales tax. See Rhoade v. Indiana Dep't of State Revenue, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

By complementing the sales tax, the use tax ensures that non-exempt retail transactions (particularly out-of-state retail transactions) that escape sales tax liability are nevertheless taxed. Id.; USAir, Inc. v. Indiana Dep't of State Revenue, 623 N.E.2d 466, 468–69 (Ind. Tax Ct. 1993). The use tax ensures that, after such goods arrive in Indiana, the retail purchasers of the goods bear their fair share of the tax burden. To trigger imposition of Indiana's use tax, tangible personal property must (as a threshold matter) be acquired in a retail transaction. Id. A taxable retail transaction occurs when (1) a party acquires tangible personal property as part of its ordinary business for the purpose of reselling the property; (2) that property is then exchanged between parties for consideration; and (3) the property is used in Indiana. See IC § 6-2.5-1-2; IC § 6-2.5-4-1(b), (c); IC § 6-2.5-3-2(a).

Generally, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. 45 IAC 2.2-5-8(a). Tangible personal property means personal property that: (1) can be seen, weighed, measured, felt, or touched; or (2) is in any other manner perceptible to the senses. IC § 6-2.5-1-27. Tangible personal property also includes electricity, water, gas, steam, and prewritten computer software. Id.

An exemption from use tax is granted for transactions where the sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are also additional exemptions from sales tax and use tax. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." Id. at 101.

A. Claim Number 278628 ("Claim One").

The Department determined that a refund of $36,168.84 was granted in error because Taxpayer's purchases were not exempt from Indiana sales/use tax.

Taxpayer, to the contrary, stated that it was entitled to the refund of the sales/use tax it paid on its purchases of equipment, including "Scrap Handling Magnet," "Generator," "Genesis Shear," "Hydraulic Breaker," pursuant to IC § 6-2.5-3-2(e) and IC § 6-2.5-5-3. Taxpayer explained that it provides "comprehensive asset retirement services for customers" and that the contracts (between Taxpayer and its customers) "often require environmental remediation and metal processing." Taxpayer thus claimed that it "produces... scrap" which was sold to "mills" or "metal brokers." Taxpayer further asserted that the "machinery and equipment [which it purchased] for its scrap-producing activities [were] initially delivered to their yard" in Indiana and were "shipped and used outside of Indiana" after its employees at the Indiana facility modified the machinery and equipment. Thus, Taxpayer maintained that it was entitled to the refund on the equipment used in Indiana pursuant to IC § 6-2.5-5-3(b) and that it was entitled to the refund on the equipment used outside of Indiana pursuant to IC § 6-2.5-3-2(e).

1. Equipment Used Outside of Indiana.

Taxpayer stated that when it purchased equipment, the vendors delivered the equipment to its Indiana facility to be modified and the equipment was subsequently shipped to various locations outside of Indiana. Thus, Taxpayer believed that it was entitled to the refund of the use tax it paid on its purchases of equipment used outside Indiana pursuant to IC § 6-2.5-3-2(e).

IC § 6-2.5-3-2, in relevant part, provides that:

> (a) An excise tax, known as the use tax, is imposed on the **storage**, **use**, or **consumption** of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.
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> ...
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> (e) Notwithstanding any other provision of this section, the use tax is not imposed on the keeping, retaining, or exercising of any right or power over tangible personal property, if:
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> (1) the property is **delivered into Indiana by or for the purchaser** of the property;
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> (2) the property is delivered in Indiana for **the sole purpose of being processed, printed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property**; **and**
>
> (3) the property is **subsequently transported out of state for use solely outside Indiana**. (**Emphasis added**).

45 IAC 2.2-3-20 states:

> All purchases of tangible personal property which are delivered to the purchaser for storage, use, or consumption in the state of Indiana are subject to the use tax. The use tax must be collected by the seller if he is a retail merchant described in Reg. 6-2.5-3-6(b)(010) [45 IAC 2.2-3-19] or if he has Departmental permission to collect the tax. If the seller is not required to collect the tax or fails to collect the tax when required to do so, the purchaser must remit the use tax directly to the Indiana Department of Revenue.

45 IAC 2.2-3-21 further provides:

> All purchases of tangible personal property which are accepted by the purchaser outside the state of Indiana

but which are stored, used, or otherwise consumed in Indiana are subject to the use tax. The use tax must be remitted directly to the Indiana Department of Revenue by the Indiana purchaser. (See 6-2.5-3-5(b)(010) [45 IAC 2.2-3-20].)

To support its claim for refund, Taxpayer submitted documentation, including, but not limited to, a summary listing the equipment at issue, purchase invoices of the equipment, records showing remittance of Indiana use tax, and records of equipment's location.

As mentioned above, Indiana imposes use tax on tangible personal property which the purchaser stores, uses, or consumes in Indiana. IC § 6-2.5-3-2(e) provides an exclusion for the use tax when all three requirements are satisfied: (1) the property is delivered into Indiana by or for the purchaser of the property; (2) the property is delivered in Indiana for the sole purpose of being processed, printed, fabricated, or manufactured into, attached to, or incorporated into other tangible personal property; and (3) the property is subsequently transported out of state for use solely outside Indiana.

Taxpayer's documentation, however, demonstrated various discrepancies. For example, Taxpayer provided a copy of its purchase invoice, dated "January 26, 2007," which showed that Taxpayer purchased ten (10) "Generator[s]" for $219,990 ($21,999 for each Generator). Taxpayer manually noted one of the Generators as "Generator #00890" on that invoice. Taxpayer's documentation, however, also showed that Generator #00890 was already in Pennsylvania on "January 10, 2007." Thus, Taxpayer's documentation failed to demonstrate that it met the above mentioned requirements outlined in IC § 6-2.5-3-2(e). Given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer demonstrated that it was entitled to the refund pursuant to IC § 6-2.5-3-2(e).

2. Equipment Used In Indiana.

Taxpayer claimed that it was entitled to the refund of the sales/use tax paid on its equipment used in Indiana based on manufacturing exemptions under IC § 6-2.5-5.

IC § 6-2.5-5-3(b) states:

Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for **direct use in the direct production**, **manufacture**, fabrication, assembly, extraction, mining, processing, refining, or finishing **of other tangible personal property**. (**Emphasis added**).

IC § 6-2.5-5-5.1(b) provides:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for **direct consumption** as a material to be consumed **in the direct production of other tangible personal property** in the person's business of **manufacturing**, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture. (**Emphasis added**).

Thus, to claim manufacturing exemptions pursuant to IC § 6-2.5-5, a taxpayer must demonstrate that (1) it is engaged in the "production of other tangible personal property"; and (2) it is in the business of "manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture." Indiana Dep't. of Revenue v. Interstate Warehousing, Inc., 783 N.E.2d 248, 250 (Ind. 2003). Additionally, the Legislature granted Indiana manufacturers a sales tax exemption for certain purchases, which are for "direct use in direct production, manufacture... of other tangible personal property." In enacting the exemption, the Legislature clearly did not intend to create a global exemption for any and all equipment which a manufacturer purchases for use within its manufacturing facility. "Fairly read, the exemption was meant to apply to capital equipment that meets the 'double direct' test." Mumma Bros. Drilling Co. v. Indiana Dep't. of State Revenue, 411 N.E.2d 676, 678 (Ind. Ct. App. 1980). The capital equipment "in order to be exempt, (1) must be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of tangible personal property." Indiana Dep't. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520, 525 (Ind. 1983). "The test for directness requires the equipment to have an 'immediate link with the product being produced." Id. Accordingly, the sales tax exemption is applicable to that equipment which meets the "double direct" test and is "essential and integral" to the manufacture of taxpayer's tangible personal property. General Motors Corp. v. Indiana Dep't. of State Revenue, 578 N.E.2d 399, 401 (Ind. Tax Ct. 1991). The application of Indiana's double-direct manufacturing exemptions often varies based on a determination of when a taxpayer's manufacturing process is considered to have begun and ended.

An exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. 45 IAC 2.2-5-8(a). Machinery, tools, and equipment are directly used in the direct production process if they have an immediate effect on the article being produced. 45 IAC 2.2-5-8(c). A machine, tool, or piece of equipment has an immediate effect on the product being produced if it is an essential and integral part of an integrated process that produces the product. Id. An integrated process is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process." 45 IAC 2.2-5-8(c), example 1.

45 IAC 2.2-5-8(g) further states:

"Have an immediate effect upon the article being produced": Machinery, tools, and equipment which are used during the production process and which have an immediate effect upon the article being produced are

exempt from tax. Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. **The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced"**. Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property. (**Emphasis added**).

45 IAC 2.2-5-8(k) describes direct production as the performance of an "integrated series of operations which transforms the matter into a form, composition or character different from that in which it was acquired, and that the change must be substantial resulting in a transformation of the property into a different and distinct product." (Emphasis added).

"Manufacture" is defined as "[a] thing that is made or built by human being, as distinguished from something that is a product of nature; esp. any material form produced by a machine from an unshaped composition of matter." Black's Law Dictionary 984 (8th ed. 2004). While statutes are silent on what constitutes "manufacture," courts, on several occasions, have attempted to answer this question through statutory construction.

In Hartranft v. Wiegmann, 121 U.S. 609 (1887), the United States Supreme Court addressed an importer's claim that it was not a manufacturer and, therefore, was exempt from "a duty of 35 per cent. ad valorem," which was imposed on manufacturers. The Court stated that:

The application of labor to an article, either by hand or by mechanism, does not make the article necessarily a manufactured article, within the meaning of that term as used in the tariff laws. Washing and scouring wool does not make the resulting wool a manufacture of wool. Cleaning and ginning cotton does not make the resulting cotton a manufacture of cotton. Id. at 615.

Ruling in favor of the importer, the Court concluded that "cleaning off the outer layer of the shell by acid, and then grinding off the second layer by an emery wheel, so as to expose the brilliant inner layer, [was] not a manufacture of the shell, the object of these manipulations being simply for the purpose of ornament, and some of the shells being afterwards etched by acid, so as to produce inscriptions upon them." Id. at 613-14.

In Anheuser-Busch Brewing Ass'n v. United States, 207 U.S. 556 (1908), a brewer claimed that it was entitled to manufacturing drawbacks for an excise tax it paid on its imported corks, which the brewer used to seal its beer bottles. The brewer maintained that it was a manufacturer of corks because, after the corks were imported from Spain and shipped to its facility, it carefully examined, sorted, cut, washed, bathed, steamed, and dried the corks. The brewer asserted that the process was necessary so it could use the corks to seal its beer bottles. Rejecting the brewer's claim, the Court stated that:

Manufacture implies a change, but every change is not manufacture, and yet every change in an article is the result of treatment, labor and manipulation. But something more is necessary, as set forth and illustrated in Hartranft v. Wiegmann, [citation omitted]. There must be transformation; a new and different article must emerge, "having a distinctive name, character or use." This cannot be said of the corks in question. A cork put through the claimant's process is still a cork. Id. at 562.

Additionally, in Indiana Creosoting Co. v. McNutt, 5 N.E.2d 310 (Ind. 1936), the Indiana Supreme Court considered a similar question. Finding the Indiana Creosoting Company was not a manufacturer, the Court elaborated that:

A manufacturer is defined to be: One who is engaged in the business of working raw materials into wares suitable for use, (or) who gives new shapes, new qualities, new combinations to matter which has already gone through some artificial process. A manufacturer prepares the original substance for use in different forms. He makes to sell, and stands between the original producer and the dealer, or first consumers, depending for his profit on the labor which he bestows on the raw material. Id. at 314. (Quoting State v. American Creosote Works, 112 So. 412, 413 (La. 1927)).

In Mechanics Laundry & Supply, Inc. v. Indiana Dep't of State Revenue, 650 N.E.2d 1223 (Ind. Tax Ct. 1995), the taxpayer, who operated a commercial laundry, claimed it was entitled to the statutory exemptions under IC § 6-2.5-5 for sales/use taxes concerning cleaning supplies, water, gas, electricity, and other products consumed during the laundering of soiled textiles. Id. 1226-27. Referring to the statutory and regulatory requirements, the Tax Court stated that the taxpayer failed to demonstrate that its "end product" was "substantially different from the component materials used." The Tax Court found that the taxpayer did not "place tangible personal property in a form, composition, or character substantially different from that in which it was acquired." Id. at 1229. The Tax Court thus concluded that the laundering of soiled textiles did not constitute "production," and, therefore, the taxpayer was not engaged "in an overall process directed to the production of textiles;" rather, the taxpayer was "perpetuat[ing] textiles that were produced by others." Id. at 1229-30. The Tax Court thus determined that the taxpayer was not entitled to the statutory exemptions outlined in IC § 6-2.5-5.

In Indianapolis Fruit Co. v. Indiana Dep't of State Revenue, 691 N.E.2d 1379 (Ind. Tax Ct. 1998), the taxpayer, Indianapolis Fruit Co., claimed that it was entitled to agricultural and manufacturing exemptions for the tangible personal property it had purchased for ripening bananas and tomatoes. The Tax Court stated that:

In the context of the exemption provisions at issue, production is "defined broadly" and "focuses on the

creation of a marketable good." The exemption provisions were enacted to deal with a host of different activities and factual situations. As a result, mathematical precision in the application of these exemptions cannot be expected, and any evaluation of whether production is occurring depends on the factual circumstances of the case. However, there is one iron-clad rule: without production there can be no exemption. Id. at 1383-84. (Internal citation and quotation marks omitted).

The court, in Indianapolis Fruit, found that the bananas had undergone substantial change and had transformed from "green, hard, inedible, and unmarketable bananas" to "yellow, edible, and sellable bananas" after the bananas were placed in air and temperature controlled banana ripening booths and the taxpayer applied ethylene gas to the bananas. Id. at 1385. The court, however, declined to find the same result for the taxpayer's tomatoes. The court determined that "production" occurred as the taxpayer created the sellable bananas, but the taxpayer did not actively perform the same or similar activities to produce the sellable tomatoes. As a result, the court, in Indiana Fruit, concluded that the taxpayer was entitled to the exemptions for its purchases of tangible personal property to be used or consumed in the bananas' production process, but not the tomatoes' production process.

Similarly, in White River Envtl. P'ship v. Indiana Dep't of State Revenue, 694 N.E.2d 1248 (Ind. Tax Ct. 1998), the taxpayer, White River Environmental Partnership (WREP), which operated a wastewater treatment facility, claimed that it was entitled to statutory exemptions for the equipment which it purchased to be used in its wastewater treatment process. The Indiana Tax Court first followed the well-established case law stating that a taxpayer must "engage in production before receiving an exemption." Id. at 1250.

The Tax Court in White River explains:

In [Mechanics Laundry & Supply, Inc. v. Indiana Dep't of State Revenue, 650 N.E.2d 1223 (Ind. Tax Ct. 1995)], **the terms listed in the exemption provisions, i.e., processing, manufacturing, etc., have meaning only to the extent that there is production. If there is no production of goods, the exemption provisions at issue do not apply**. Therefore, WREP's entitlement to a sales and use tax exemption rests not on whether wastewater treatment can be called processing, but rather whether WREP is engaged in the production of goods.

...

[T]he fact that WREP substantially changes the wastewater does not ispo *[sic]* facto lead to the conclusion that production for purposes of the exemption provisions is taking place. **Production, within the context of the exemption provisions at issue, is "defined broadly" and "focuses on the creation of a marketable good." In this case, the "products" of the wastewater treatment process (clean water, ash, and sludge) are not sold to others**. The clean water is discharged into the White River, and the ash and sludge are disposed of in a landfill. Id. at 1250-51. (Internal citation and quotation marks omitted). (**Emphasis added**).

The Tax Court, in White River, further referred to Mumma Bros., where the Indiana Court of Appeals determined that the taxpayer, who drilled water wells and installed pumps and plumbing for residences, farms, and commercial entities in order to provide water for animal and human consumption, was not entitled to exemptions because the taxpayer did not produce a marketable good. Following the same analysis in Mumma Bros., the Tax Court in White River illustrated:

The legislature enacted the sales and use tax exemption in order to prevent tax pyramiding, i.e., a situation where a tax is levied upon a tax. In Mumma Bros., a situation where the "**product**," i.e., the extracted water, **was not resold, there was no tax pyramiding to prevent**. Accordingly, the purposes of the exemption were not served. In light of this and the fact that a tax exemption is strictly construed, the court found that the exemption was not meant to apply to the extraction of water for personal use. Id. at 1252. (Internal citation and quotation marks omitted). (**Emphasis added**).

Thus, the Tax Court in White River determined that WREP, like the taxpayer in Mumma Bros., was not entitled to statutory exemptions because WREP failed to demonstrate that it produced a marketable good. The Tax Court concluded that "[w]here something is made, but not sold, the danger of tax pyramiding does not exist." Id.

Furthermore, in Interstate Warehousing, the taxpayer, Interstate Warehousing, Inc. ("Interstate"), claimed that it was entitled to an exemption under IC § 6-2.5-5-5.1 on its consumption of the electricity used to convert the ammonia from a gas to a liquid. Interstate Warehousing, 783 N.E. 2d at 249. The Tax Court ruled in favor of the taxpayer. The Indiana Supreme Court, in reversing the Tax Court's determination, found that the taxpayer was not qualified for the exemption in two respects: the court found that (1) the taxpayer was not engaged in the "production of other tangible personal property" (namely, the "distinct marketable good" requirement); and (2) the taxpayer was not in the business of "manufacturing, processing, refining, repairing, mining, agriculture, horticulture, floriculture, or arboriculture" (namely, the "transformation" requirement). Id. at 250. The court, in pertinent part, explained that:

Interstate uses electricity to cool gaseous ammonia to liquid form and then circulates the liquid through its warehouse facilities to cool the air. When the temperature of the ammonia begins to rise, it is again chilled. The ammonia stays in the refrigeration system, which was referred to as "closed loop." While it is certainly

> true that there is some transformation of the ammonia from gas to liquid form as a consequence of the consumption of electricity, such transformation alone is not sufficient to constitute "production of other tangible personal property" under the statute. **By "production of other tangible personal property," the Legislature meant that the taxpayer must use the electricity to transform the ammonia into a distinct marketable good. That does not occur here; the liquid ammonia is never marketed**.
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> ...
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> Interstate [does not] perform an integrated series of operations resulting in a transformed end product to Interstate's customer.... The cool air merely maintains the customer's previously manufactured goods. There is no substantial change in "form, composition, or character" to those goods. **The cold air is only incidental to the service of storing previously manufactured goods**. (**Emphasis added**).
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> Id. at 250-52.

Taxpayer, in this instance, referring to Cave Stone and Rotation Products Corp. v. Indiana Dep't of State Revenue, 690 N.E. 2d 795 (Ind. Tax Ct. 1998), asserted that it "is a re-manufacturer, not a scrap 'recycler'." Taxpayer, in relevant part, explained that:

> [Its] production process begins with the extraction of materials such as plate and structural steel from existing structures and buildings. In the current form, the steel is providing structural support for the bridge or building. However, the metal is not currently sellable because it may be encased in concrete and other materials. [Its] production process removes the concrete from its raw materials and transforms it into prepared grades of iron and steel for use in foundries, mills, and smelters of its customers. Consequently, [its] processed scrap metal must meet particularized customer specifications and industry standards. Most of its products – scrap bundles, scrap shredded, scrap turning, copper scrap, scrap heavy melting – must meet size, density, content, and metallurgical requirements. It is also required to provide certification with all shipments that the product meets specifications.
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> Taxpayer also outlined six steps of its "manufacturing process of ferrous material," as follows:
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> (1) Locate source of raw material. Three examples of locations of **raw materials are buildings, tanks, and bridges**.
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> (2) Contaminants such as **wood, drywall, brick, and concrete need to be removed** from ferrous material.
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> (3) Ferrous material must be **reduced to manageable-sized pieces**.
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> (4) Ferrous material is then **sorted into four main categories** which include plate and structural, heavy melt, sheet product, and rebar.
>
> (5) Once ferrous material is **sorted** into four main categories, materials must then be **processed to the customer's specification**. An example of this would be plate and structural being processed to **a 2 × 2 × 2 specification**.
>
> (6) Once material has been processed to the customer's specifications, it is held for future loading and **shipping to the customer**. (**Emphasis added**).

To support its protest, Taxpayer submitted additional photos showing its use of the equipment such as demolishing buildings and bridges as well as cutting and moving the debris and scrap. Additionally, Taxpayer provided sample invoices demonstrating that it sold "scrap plate and structural" as well as "iron or steel scrap" to its customers, the steel production companies. Taxpayer, however, declined to provide any copy of contracts it executed with the owners who used Taxpayer's "asset retirement" services (i.e., the sources of Taxpayer's raw materials) and its customers who purchased the scrap metals, claiming they were confidential.

Taxpayer's reliance is misplaced. Taxpayer may argue that it "begins its manufacturing process with the removal of its raw materials (i.e., the concrete-encased steel) from existing structures." Upon reviewing Taxpayer's documentation, however, its documentation demonstrated that it was in the business of providing "asset retirement" services and its equipment was primarily used in destroying, removing, tearing down, or demolishing existing buildings or bridges, and disposing of the debris as a result. Unlike the taxpayer in Cave Stone, Taxpayer was not in the business of mining (or processing) and did not use its equipment to produce sellable/marketable goods. Taxpayer's documentation demonstrated that it used its equipment to demolish buildings or bridges and produced "debris" as a result. Thus, the scrap metals, at best, were byproducts of its "asset retirement" services – namely, the result of its demolition activities.

Additionally, the Tax Court in Rotation Products established a four-part test of determining what repair activity might rise to the level of remanufacturing; Taxpayer's demolition activities were not repair activities. Although Taxpayer may argue that its "asset retirement" services were complex, demolishing buildings or bridges is very different from "repair" activities. Thus, Rotation Products is not applicable.

Furthermore, Taxpayer may argue that it used the equipment to reduce the ferrous material to manageable-sized pieces as well as to sort, cut, and bale the ferrous material to meet its customers' specification, such as the scrap of "plate and structural being processed to a "2 × 2 × 2 specification." However, simply reducing the size of the scrap metals by "sorting," "cutting," and "baling" does not meet the statutory requirement of "substantial change" and "transformation" of the raw materials into distinct marketable goods even though Taxpayer claimed that it could sell them to the steel mills.

One man's trash may be another man's treasure. However, simply separating/removing the unwanted parts,

and sorting, cutting, and baling the salvaged parts (scrap metals) to be sold to the steel mills does not make Taxpayer a re-manufacturer of the "scrap metals." Thus, given the totality of the circumstances, in the absence of other supporting documentation, the Department is not able to agree that Taxpayer demonstrated that it was engaged in the manufacturing of scrap metal and therefore was entitled to the manufacturing exemptions pursuant to the above mentioned statutes, regulations, and case law. Since the Department determines that Taxpayer was not engaged in the business of "re-manufacture," the Department does not need to review whether Taxpayer's equipment at issue was directly used in Taxpayer's direct "re-manufacturing process."

In conclusion, Taxpayer was not entitled to the statutory exemptions pursuant to IC § 6-2.5-3-2(e) and IC § 6-2.5-5.

B. Claim Number 287434 ("Claim Two").

The Department determined that a refund of $30,237.37 (including interest) was granted in error because Taxpayer's purchases were not exempt from Indiana sales/use tax.

Taxpayer stated that it was entitled to the refund of Claim Two for the sales/use tax it paid on its purchases of tangible personal property within its expense account, including, but not limited to, washers, locks, o-rings, short rivets, connectors, wirings, filters, plugs, adapters, rods, mask types, switches, and hoses. Similar to Claim One, Taxpayer claimed that it was entitled to manufacturing exemptions pursuant to IC § 6-2.5-5-5.1.

As discussed extensively in Part A. 2., the Department determined that Taxpayer was in the business of providing "asset retirement" services and was not engaged in re-manufacture. Also, as discussed in Part A. 2., Taxpayer's documentation demonstrated that its equipment was primarily used in destroying, removing, tearing down, or demolishing existing buildings or bridges, and disposing of the debris as a result. Thus, Taxpayer was not entitled to the exemption for its purchases of the replacement parts for its equipment used in providing the asset retirement services.

In short, Taxpayer was not entitled to the exemption under IC § 6-2.5-5-5.1.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration – Interest.

DISCUSSION

The Department assessed interest on the tax liabilities. Taxpayer protested the imposition of interest.

IC § 6-8.1-10-1(a) provides, as follows:

If a person fails to file a return for any of the listed taxes, fails to pay the full amount of tax shown on the person's return by the due date for the return or the payment, or incurs a deficiency upon a determination by the department, the person is subject to interest on the nonpayment.

Pursuant to IC § 6-8.1-10-1(e), the Department does not have the authority to waive the interest.

FINDING

Taxpayer's protest regarding the imposition of interest is respectfully denied.

III. Tax Administration – Negligence Penalty.

DISCUSSION

The Department's audit imposed a ten percent negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a ten (10) percent negligence penalty if the taxpayer:

(1) fails to file a return for any of the listed taxes;

(2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

(4) fails to timely remit any tax held in trust for the state; or

(5) is required to make a payment by electronic funds transfer (as defined in IC 4-8.1-2-7), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department.

45 IAC 15-11-2(b) further states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in 45 IAC 15-11-2(c), in part, as follows:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause,

the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

(1) the nature of the tax involved;
(2) judicial precedents set by Indiana courts;
(3) judicial precedents established in jurisdictions outside Indiana;
(4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

In this instance, Taxpayer either had paid the sales tax at the time of its purchases or timely self-assessed the use tax to the Department during the tax years at issue. Thus, the Department notes that the imposition of negligence penalty is inappropriate in this case.

In short, Taxpayer's protest of the imposition of negligence penalty is sustained.

FINDING

Taxpayer's protest is sustained.

SUMMARY

For the reasons discussed above, Taxpayer's protest of the imposition of sales/use tax is denied. Taxpayer's protest of the imposition of interest is respectfully denied. Taxpayer's protest of the imposition of the negligence penalty is sustained.

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